BURKE, WILLIAMS & SORENSEN, LLP

2280 Market Street - Suite 300
Riverside, California 92501-2121
voice 951.788.0100 - fax 951.788.5785
www.bwslaw.com

Direct No.: 951.801.6610
Our File No.: 05110-0001
jbiggs@bwslaw.com

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Members of the Board of Supervisors
County of Los Angeles
Hall of Administration Office
856 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, CA 90012

Re: City of East Los Angeles – Request for Agenda Item: Designation of Revenue Neutrality Negotiating Committee

Dear Members of the Board of Supervisors:

As you are all aware, during the last four years citizens of the unincorporated area now known as East Los Angeles have been pursuing incorporation of their community into a new California city. An application has been filed, preliminary fiscal review completed showing fiscal viability for a new city, petitions have been circulated garnering signatures from 33% of the registered voters in the community and a formal Comprehensive Fiscal Analysis ("CFA") has been prepared and certified by the Los Angeles Local Area Formation Commission ("LAFCO").

The CFA that has been certified by LAFCO, however, does not include any consideration of revenue neutrality between the County of Los Angeles ("County") and the proposed new City of East Los Angeles ("City of East L.A."). The reason for this omission is that neither LAFCO nor the County has initiated revenue neutrality discussions, and to date the proponents of incorporation have been directed to the County CEO on this issue for discussion.

At the hearing held by LAFCO on January 25, 2012, Supervisor Molina stated that the CEO has no authority to negotiate on behalf of the Board on the issue of revenue neutrality. She stated that it was the obligation of the proponents of incorporation to put the matter on the County agenda for action by the Board. Since the proponents have no authority to set the County agenda, this letter has been prepared asking that one or more members of the Board of Supervisors take the requisite action necessary to get this matter before the Board for action.

The proponents are requesting simply that the Board designate and authorize County representatives to serve on a revenue neutrality committee with the proponents of incorporation. The importance of revenue neutrality negotiations under the law cannot be stressed enough. It is the heart of due process with regard to the formation of new cities in California. Further, there are substantial funds available according to the CFA that can be used to enhance the financial condition of both the County and the proposed City if incorporation is successful. A positive outcome for everyone is possible if both parties approach this issue in good faith.

The draft Comprehensive Fiscal Analysis ("CFA") was submitted and approved for circulation in June of 2011. That CFA, which has not been materially changed since its initial submission, shows that the County will realize approximately $27,000,000 in savings annually upon incorporation of the City of East L.A. That number represents the reduction in the cost to the County of providing services to the incorporation area that will occur once the City is formed. Because the transfer of the obligation to provide services to the incorporation area does not include all revenues now used by the County to pay for those services, the current funding structure proposed for incorporation of the City of East L.A. would result in insufficient revenues to cover the cost of continuing to provide law enforcement and other services at the same level now provided by the County. Appropriate revenue neutrality mitigation measures can rectify this situation.

A review of the procedures that govern incorporation of new cities in California with regard to revenue neutrality is helpful in understanding the current situation. Government Code Section 53815 requires that the allocation of revenues necessary to continue existing services by a new city be sufficient for that purpose. To assist in the processing of incorporation applications, the California Office of Planning and Research ("OPR"), under a statutory mandate, has published a guide entitled "A Guide to the LAFCO Process for Incorporations" (the "*Guide*"). The *Guide* states the official policy of the State of California with regard to the incorporation process and more specifically with regard to the requirements of Government Code Section 53815 with regard to revenue neutrality. The *Guide* states:

> ". . . LAFCO cannot approve a proposal for incorporation unless it finds that the amount of revenues the new city receives from the county and affected agencies after incorporation would be substantially equal to the amount of savings the county or the affected agencies would attain from no longer providing services to the proposed incorporation area. A broad range of mitigation measures is permitted as is a less-than-substantially equal exchange if the county and affected agencies agree to the

> transaction." (*Guide* at p. 39)

The *Guide* also sets forth the official position of the State of California with regard to impartial effect of Government Code Section 56815 as follows:

> "The revenue neutral standard in law (§56815i(a)) is: 'that any proposal that includes an incorporation should result in a similar exchange of both revenue and responsibility for service delivery among the county, the proposed city and other subject agencies'. Section 56815(b) prohibits LAFCO's approval of an incorporation proposal unless it finds that revenues and expenditures are substantially equal." **Section 56815 thus favors neither the new city nor the county or district.** Section 56815(c)(1) does provide authority for LAFCO to approve a proposal that is not revenue neutral if both (all) parties agree to the proposal's fiscal effects." (*Guide* at p. 40)

It is important to note that a revenue neutrality agreement is only necessary if the parties are willing to agree to less than an equal exchange. If no agreement among the affected parties can be reached, the *Guide* states that appropriate terms and conditions may be imposed by LAFCO to assure revenue neutrality. (*Guide* at pp. 42, 47)

The *Guide* sets forth the appropriate time frame for revenue neutrality negotiations. The *Guide* notes:

> "The terms of a revenue neutrality agreement must be negotiated between the proponents, county and special district officials in accordance with a policy adopted by the local LAFCO.
>
> Revenue neutrality negotiations are initiated during the preparation of the CFA. After the preliminary results of the CFA are compiled, the county, proponents and LAFCO use the information to structure payments for revenue neutrality. The negotiated terms of the agreement are then used to create the public hearing draft of the CFA for consideration by LAFCO during the public hearing on incorporation." (Guide, p. 43)

The role of LAFCO is also addressed in the *Guide* as follows:

> "The role of LAFCO staff in the revenue neutrality process is to facilitate discussions and to ensure compliance with the revenue neutrality requirements.

After completion of the Draft CFA, LAFCO staff should convene a revenue neutrality negotiating committee composed of representatives of the county, other affected agencies and the proponents of the proposed incorporation during preparation of the CFA. The role of the revenue neutrality committee is to develop a mitigation agreement.

Due to the schedule of most incorporations, it is recommended that the revenue neutrality committee complete negotiation of the agreement within 90 days; however, this should remain flexible as long as the schedule and progress toward an agreement is being maintained. At the conclusion of the negotiating period, LAFCO"s Executive Officer will certify that an agreement has been reached or has not been reached.

. . . .

If the negotiating parties do not reach agreement, the status of the negotiations should be referred to LAFCO for discussion of outstanding issues at the first available meeting as determined by the Executive Officers. If revenue neutrality issues are not resolved, OPR recommends that LAFCO staff draft proposed terms and conditions dictating revenue neutrality terms for use in the comprehensive fiscal analysis and for recommendation to LAFCO at its public hearing." (Guide, pp. 46-47)

The *Guide* also outlines methods by which LAFCO may achieve revenue neutrality by agreement or by imposition of terms and conditions. Those designated methods include: 1) continuation of services following incorporation; 2) payments and taxes required by changes in service responsibilities or for revenue neutrality; 3) disposition of money, property and rights of use, such as water or utility capacity rights; 4) disposition of special district responsibilities, district governing boards and employees; and 5) the effective date of incorporation. To date, none of these approaches has been considered by LAFCO staff or its Executive Officer.

Unfortunately, LAFCO has failed to follow the *Guide* procedures with regard to revenue neutrality and has not convened the required revenue neutrality committee nor has it facilitated any revenue neutrality discussions among the parties.

In the absence of any LAFCO directed revenue neutrality process, the findings in the CFA show that the "amount of savings the county ... would attain from no longer providing services to the proposed incorporation area" amounts to nearly $27,000,000 annually. If this savings amount were allocated to the new City to cover provision of the current level of public services either by a revenue neutrality agreement or by terms and conditions imposed by LAFCO, no shortfall would occur in the new City. Proponents, however, are not suggesting that a full allocation of the County savings to the new City is appropriate. In an effort to move the process forward for the benefit of both the County and the new City, proponents have instead submitted several outlines as to how the City could be fiscally viable under the current CFA. The proponents further contend that good faith negotiation of revenue neutrality terms coupled with some of the changes suggested under the current CFA will result in both the County and the new City benefiting from incorporation.

Importantly, one reason there is such a disproportionate savings to the County is clear. At least $16,000,000 in revenues now being expended to cover law enforcement services in the incorporation area are not shown as being transferred to the new city upon incorporation. These revenues are restricted revenues generated under the provisions of Proposition 172. Proposition 172 was enacted in 1993 to increase the state sales tax by ½ percent. The revenue is required to be distributed to local governments for public safety services.

LAFCO requested and received a legal opinion from outside counsel that confirms that Proposition 172 revenues are indeed restricted revenues that must only be expended for local law enforcement purposes. That legal opinion then contends that under the provisions of Government Code Section 56810, this means that they need not be taken into effect for purposes of allocation of the property taxes for the new City. This is all true. As noted in the *Guide*:

> "Restricted and unrestricted revenues should be evaluated separately. An agency could pay a portion of its annual revenue neutrality payment with restricted funds if both agencies agree and a legally enforceable mechanism for payment can be created." (*Guide* at p. 44)

This policy, endorsed by the State of California, makes it clear that even though Proposition 172 funds are restricted and may only be used for local law enforcement purposes, agreements can be reached to make such funding available to a new city for law enforcement purposes. Thus, while cities that incorporate after 1992 are not entitled to receive such funds directly, other funding structures may be devised to assure that Proposition 172 funds used for the benefit of an incorporation area, continue to be expended for law enforcement purposes there after incorporation.

As currently structured, the incorporation will transfer all responsibility for providing law enforcement services within the new City to the City, but will not transfer any portion of the Proposition 172 funds now supporting those services. It is clear to the proponents that under 56815, transferring only the obligation to provide existing services without transferring appropriate funding is contrary to the law. Either a binding agreement requiring the new City to use all Proposition 172 funds only for public safety purposes or a credit against the cost of contracting with the County for those services should be implemented in order to abide by the legal requirements of Government Code 56815.

In the recent incorporations in Menifee and Wildomar in Riverside County, for example, it was determined that the County would receive a disproportionate benefit similar, although much smaller, than what would result for the County of Los Angeles in the East L.A. incorporation. In response to that unequal exchange, the County and proponents of incorporation negotiated revenue neutrality agreements that required the County to augment revenues in each city. In order to create a valid and binding agreement, the parties entered into agreement that provide a credit against county-contracted law enforcement services for each city in the amount of the savings that resulted to the county as a result of incorporation. This credit-for-services arrangement does not affect Proposition 172 funding nor does it violate the provisions of Proposition 172.

The proponents have requested a continuance of LAFCO proceedings to pursue appropriate revenue neutrality negotiations or in the alternative to permit LAFCO staff time to prepare appropriate terms and conditions that will be imposed to assure that the proposed incorporation will be revenue neutral as to all affected agencies. The proponents believe that there is a win-win option here that will result in the County retaining a significant portion of the $27,000,000 savings while assuring fiscal viability for the new City.

Finally, the proponents note that as the County reviews this letter, it may wish to seek legal advice and analysis. Since County Counsel has provided legal advice for LAFCO throughout the incorporation process, they believe it would be appropriate for the County to obtain outside legal advice on this issue.

In closing, the proponents of incorporation urge the Board of Supervisors to designate and authorize representatives to serve on a revenue neutrality committee to negotiate in good faith an appropriate allocation of existing funding to permit the formation of the new City of East L.A.

Sincerely,

Julie Hayward Biggs,
Of Counsel
Burke, Williams & Sorensen, LLP

cc: Members of LAFCO
Paul Novak